



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	02/22/05	Bill No:	SB 942
Tax:	Cigarette Pollution and Litter Prevention Fee	Author:	Chesbro
Related Bills:	AB 1612 (Pavley)		

BILL SUMMARY

This bill would require each manufacturer of cigarettes to pay a cigarette pollution and litter prevention fee for each package of cigarettes sold by that manufacturer in California, as specified.

ANALYSIS

Current Law

Pursuant to Revenue and Taxation Code Section 30101 (Cigarette and Tobacco Products Tax Law), an excise tax of 6 mills (or 12 cents per package of 20) is imposed on each cigarette distributed. In addition, Sections 30123 and 30131.2 impose a surtax of 12 1/2 mills (25 cents per package of 20) and 25 mills (50 cents per package of 20), respectively, on each cigarette distributed. The current total tax on cigarettes is 43 1/2 mills per cigarette (87 cents per package of 20).

Of the 87 cent excise tax imposed on a package of 20 cigarettes, 2 cents is deposited into the Breast Cancer Fund, 10 cents into the General Fund, 25 cents into the Cigarette and Tobacco Products Surtax Fund, and 50 cents into the California Children and Families First Trust Fund (CCFF Trust Fund).

Proposed Law

This bill would add Division 12.8 (commencing with Section 19000) to the Public Resources Code as the Cigarette Pollution and Litter Prevention Act of 2005 (Act).

CIGARETTE POLLUTION AND LITTER PREVENTION FEE

This bill would require each manufacturer to pay, on July 1, 2006, a cigarette pollution and litter prevention fee for each package of cigarettes sold in the state by that manufacturer during the previous six month calendar year. Each six months thereafter, a manufacturer would be required to pay the fee to the Department of Conservation (Department) based upon the number of packages of cigarettes sold in the state during the previous six months. The Department would be required to notify each manufacturer of the amount due based on the number of packages of cigarettes sold in the state, as previously reported to the Department.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.

The department would collect the fees pursuant to the Fee Collection Procedures Law (Part 30 (commencing with Section 55001) of Division 2 of the Revenue and Taxation Code). The department would be authorized to contract with the State Board of Equalization (Board) or another party for collection of fees due.

This bill also provides that a manufacturer is required to annually pay the fee and that the fee paid by the manufacturer would be in amount that is not greater than the costs of the environmental, public health, and societal burdens that are mitigated pursuant to the Act.

FINANCIAL PROVISIONS

The Department would deposit all fees collected under this chapter into the Cigarette Pollution and Litter Prevention Fund (Fund), which this bill would create in the State Treasury. The revenues in the Fund would be available for expenditure by the Department of Conservation and the State Department of Health Services, upon appropriation by the Legislature, for all of the following purposes and programs:

- To help offset state government, local government, and other public agency costs associated with the cleanup of cigarette-related litter and to mitigate cigarette-related pollution.
- To develop and implement public education and outreach programs by public agencies and nonprofit organizations aimed at educating the public on the public health and environmental problems resulting from the improper discard of cigarette remnants.
- To develop and implement programs by public agencies and nonprofit organizations aimed at reducing the source of cigarette-related litter and pollution and the resulting public cost.
- To assist individuals to access and utilize smoking cessation services.
- To develop and implement public education, media advertising, and outreach programs aimed at preventing individuals from starting to smoke.
- To develop and implement effective community interventions aimed at reducing the harm caused by cigarettes.
- To reimburse the Board for its costs of administration and collection of the cigarette pollution and litter prevention fee.
- To provide for the costs of administering the Act.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.

DEFINITIONS

This bill would define the following terms:

- "Cigarette" - any product that contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains any roll for smoking, made wholly or in part of tobacco, irrespective of size or shape and irrespective of whether the tobacco is flavored, adulterated or mixed with any other ingredient, where the roll has a wrapper that is wholly or in the greater part made of tobacco and the roll weighs over three pounds per thousand.
- "Cigarette package" - an individual packet, box or other container in which retail sales of cigarettes are normally made or intended to be made. "Package" does not include a container that is a carton, case, bale or box and that contains smaller packaging units of cigarettes.
- "Manufacturer" - a person who manufactures a cigarette.

The bill would become effective January 1, 2006.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the American Lung Association and Californians Against Waste and is intended to hold manufacturers of cigarettes financially liable for all of the adverse public health and environmental effects of their products, including tobacco addiction and cigarette related litter.
2. **This measure would exclude products typically defined as a cigarette.** As defined in this measure, the term cigarette would only include product "where the roll has a wrapper that is *wholly or in the greater part made of tobacco...*". This definition does **not** include products where the wrapper or cover is made of paper or any other material. As such, this bill would only impose a cigarette and litter prevention fee upon a manufacturer for packages of little cigars, which are wrapped in a leaf tobacco, sold in the state. Cigarettes, which are wrapped in paper or any other material not containing tobacco, would not be counted for purposes of imposing the fee.
3. **Would this fee capture all cigarettes sold in California?** This bill would require each manufacturer to pay a cigarette pollution and litter prevention fee for each package of cigarettes sold by that manufacturer in the state, as specified. In its current form, this fee would not capture cigarettes sold in the state by persons other than the manufacturer. For example, it is not uncommon for a licensed distributor located in another state to purchase cigarettes from a manufacturer in that state, affix a California cigarette tax stamp, and ship those cigarettes into California for sale to a California consumer. Under such a scenario, the sale by the manufacturer takes place outside California and would not be subject to the proposed fee.

Furthermore, manufacturers could easily avoid this fee by not selling cigarettes in the state. Instead, manufacturers could sell cigarettes to distributors outside the state for subsequent shipment into the state by that distributor.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.

If it is the author's intent to capture the fee on all cigarettes sold in this state, it is suggested that the fee imposed upon manufacturers be based on packages of cigarettes distributed in California. Cigarettes distributed in California would include those packages of cigarettes upon which a California cigarette tax stamp has been affixed. The bill should also include provisions to require distributors to report the number of packages of cigarettes stamped by manufacturer for purposes of imposing the appropriate fee upon manufacturers and revise the definition of cigarette to be consistent with the Cigarette and Tobacco Products Tax Law. This suggestion, however, would impose an additional reporting requirement upon licensed distributors.

And lastly, it should also be noted that collecting the proposed fee from foreign manufacturers would be difficult, if not impossible, if that manufacturer does not have nexus within this state. Therefore, it is suggested that the fee also be imposed upon importers of cigarettes sold in this state and that the term importer be defined. The term "importer" should have the same meaning as that term is defined in Section 30019 of the Revenue and Taxation Code, which provides that an importer is any purchaser for resale in the United States of cigarettes manufactured outside of the United States.

4. **This bill does not specify a fee amount.** This bill provides that the fee paid by the manufacturer shall be in amount that is not greater than the costs of the environmental, public health, and societal burdens that are mitigated pursuant to the Act. This provision is vague as to how the fee amount would be established. For example, what agency would be responsible for computing the amount of the fee? How would the fee be computed? How often would the fee rate change? Would the Board be notified timely of fee amounts in order to bill manufacturers?

In order to properly administer this new fee program, it is necessary that guidelines of how and by whom the fee is to be calculated be clearly provided in law. Without clear guidance, administration of the proposed fee would add a significant level of complexity and disputes.

5. **This bill does not provide lead-time for manufacturers to report.** This bill would impose a fee on July 1, 2006 for each package of cigarettes sold in the state during the previous six months. Each six months thereafter, each manufacturer would pay the fee based on the number of packages of cigarettes sold in the state during the previous six months. As such, the fee on packages of cigarettes sold from January 1, 2006 through June 30, 2006 would be due to the Board on July 1, 2006. This and all subsequent due dates would only be one day following the last day of the period for which the packages of cigarettes were sold. This does not allow sufficient time for the Board to generate billings or for the manufacturer to pay the fee. It is suggested that the fee be due on or before 30 days from the date of the Board's determination (billing).
6. **The language designating the Department to collect the fee is contradictory and confusing.** In its current form, the bill provides in Section 19003(c) that the Department "may collect the fees imposed pursuant to this section pursuant to the Fee Collection Procedures Law..." .

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.

However, the Fee Collection Procedures Law contains "generic" administrative provisions specific to the Board for the administration and collection of fee programs to be administered by the Board. The Fee Collection Procedures Law was added to the Revenue and Taxation Code to allow bills establishing a new fee to be collected by the Board to reference this law, thereby only requiring a minimal number of sections within the bill to provide the necessary administrative provisions. Among other things, the Fee Collection Procedures Law includes collection, reporting, refund and appeals provisions, as well as provides the Board the authority to adopt regulations relating to the administration and enforcement of the Fee Collection Procedures Law.

As such, Section 19003(c) should be amended to provide that if the Department elects to contract with the Board to collect the fee, the Board shall collect the fee in accordance with the Fee Collection Procedures Law.

7. Other technical concerns. Board staff is working with the author's office in drafting appropriate amendments to address the following concerns:

- It is suggested that the bill be amended to authorize the payment of refunds on overpayments of the fee from the Fund.
- This bill provides in Section 19003(a) that a manufacturer shall annually pay the proposed fee; however, subdivision (b) of that same section imposes a biannual fee. And lastly, the definition of "package" should be amended to read:

"Package" does not include a container that is a carton, case, bale or other box ~~and~~ that contains smaller packaging units of cigarettes.

- Section 19004(a), which is contained in Chapter 4, provides that the Department shall deposit all fees collected under this "chapter" into the Fund. However, there are no fees collected under Chapter 4. The proposed fees are collected pursuant to Chapter 3. As such, the reference to "this chapter" in Section 19004(a) should be revised to read "chapter 3" or "division."

8. This bill could increase state and local sales and use tax revenues. In order to be reimbursed for the fee, cigarette manufacturers may increase the price of cigarettes, which would be reflected in the retail sales price of cigarettes sold to the ultimate consumer.

Sales and use tax is due based on the gross receipts or sales price of tangible personal property in this state. Since the proposed fee would not be specifically excluded from gross receipts or sales price, it would be included in the amount on which sales or use tax is computed.

9. Would the proposed cigarette pollution and litter prevention fee increase evasion? Tax evasion is one of the major areas that can reduce state revenues from cigarettes and tobacco products. Board staff recently estimated that cigarette tax evasion in California was running at a rate of approximately \$292 million annually. That estimate was only for evasion of cigarette taxes, and did not include associated evasion of other taxes, such as sales and use, tobacco products or income taxes.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.

A key premise in the Board's research is that both cigarette consumption and cigarette tax evasion are highly correlated to product prices and excise tax rates. For example, two major events that occurred since November 1998 dramatically increased California excise taxes as well as cigarette prices excluding taxes: Proposition 10 and the Tobacco Master Settlement Agreement made between states and tobacco manufacturers (tobacco settlement). Together, these two developments, when coupled with typical wholesaler and retailer distribution margins, have increased average prices of cigarettes to California consumers by about 50 percent in relation to early November 1998 prices. It was estimated that the impacts of Proposition 10 and the tobacco settlement more than doubled cigarette tax evasion in California.

This bill would impose an unspecified fee on each person who manufactures a cigarette, as specified. This fee could result in an increase in the selling price of cigarettes, which based on the Board's findings when developing the impacts of Proposition 10 and the tobacco settlement, could cause a correlated increase in tax evasion.

10. **Sinclair Paint Company Court decision.** In July 1997, the California Supreme Court held that the Childhood Lead Poisoning Prevention Act of 1991 imposed bona fide regulatory fees and not taxes requiring a two-thirds vote of the Legislature under Proposition 13. In summary, the Court found that while the Act did not directly regulate by conferring a specific benefit on, or granting a privilege to, those who pay the fee, it nevertheless imposed regulatory fees under the police power by requiring manufacturers and others whose products have exposed children to lead contamination to bear a fair share of the cost of mitigating those products' adverse health effects.

This measure would impose a cigarette pollution and litter prevention fee that would be used to fund specified purposes and programs. In part, the fee revenues would fund purposes and programs to help offset state government, local government, and other public agency costs associated with the cleanup of cigarette litter and to mitigate cigarette related pollution, and to develop and implement public education and outreach programs. The fee revenues would also be used to fund purposes and programs to assist individuals to access and utilize smoking cessation services, to develop and implement public education, media advertising, and outreach programs aimed at preventing individuals from starting to smoke, and to develop and implement community interventions.

It could be argued that the funding for purposes or programs to provide smoking cessation services and outreach to prevent individuals from starting to smoke are not "mitigating effects" comparable in character to similar police power measures imposing fees to defray the actual or anticipated adverse effects of the manufacturers business operations. Therefore, opponents of this measure could argue that the fee imposed by this measure is not consistent with the California Supreme Court decision in *Sinclair Paint Company v. State Board of Equalization* (1997) 15 Cal.4th 866.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.

11. **Related legislation.** This bill contains similar fee language as Assembly Bill 1612 (Pavley). However, Assembly Bill 1612 would require the Board to notify each manufacturer of the amount of fee due and collect the fees pursuant to the Fee Collection Procedures Law.

COST ESTIMATE

The provisions of this bill would authorize the Department to contract with the Board to perform collection functions related to the cigarette pollution and litter prevention fee. The Board would be reimbursed by the Department for its preparation and ongoing costs to administer the fee.

If the Department were to contract with the Board to collect the proposed fee, the Board would incur new non-absorbable costs associated with the workload to adequately develop and administer this new fee program. This workload would include registering fee payers, developing computer programs, mailing and processing returns and payments, conducting audits, developing regulations, training staff, and answering inquiries from the public. A cost estimate of this workload is pending.

REVENUE ESTIMATE

Currently, this measure does not specify the amount of the cigarette litter and prevention fee. Accordingly, a revenue estimate could not be prepared.

Analysis prepared by:	Cindy Wilson	916-445-6036	04/11/05
-----------------------	--------------	--------------	----------

Contact:	Margaret S. Shedd	916-322-2376
----------	-------------------	--------------

mcc

0942-1cw.doc

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.